FitchRatings

FITCH RATES IOWA'S $293MM SRF BONDS 'AAA'; OUTLOOK STABLE

Fitch Ratings-Chicago-04 November 2010: Fitch Ratings assigns an 'AAA' rating to the following Iowa Finance Authority (the authority) state revolving fund (SRF) revenue bonds:

--$89,870,000 State Revolving Fund revenue bonds, series 2010A;
--$203,185,000 State Revolving Fund revenue bonds, taxable series 2010B (Build America Bonds [BAB] - Direct Payment).

The bonds are expected to sell via negotiation during the week of Nov. 8, 2010. Bond proceeds will be used to reimburse the authority for qualifying wastewater and drinking water infrastructure loans already made to local governments throughout the state, to fund new loans and to refund portions of certain outstanding bonds.

In addition, Fitch affirms its 'AAA' rating on the following bonds:

--$480,445,000 revolving fund revenue bonds.

The Rating Outlook is Stable.

RATING RATIONALE:
--Pledged resources of the authority's leveraged clean water and drinking water state revolving funds (SRF), under an amended and restated Master Trust Agreement (MTA), allow the combined bond program to withstand high levels of underlying borrower defaults without causing bond payment interruptions.
--The amended MTA pledges the equity fund to bondholders providing credit enhancement to bondholders.
--Borrower loans are secured by water and/or wastewater pledges or general obligation pledges. The portfolio's loan credit quality reflects predominately nonrated borrowers.

KEY RATING DRIVERS:
--Credit quality of the bonds is linked to diversification and credit characteristics of the borrowers in the pledged portfolio and the size and credit quality of existing invested reserves.
--The authority's ability to balance future leveraging with capitalization grants and program resources to maintain borrower default tolerance levels that pass Fitch's 'AAA' stress test scenarios is important to maintaining the rating on the bonds.

SECURITY:
--The 2010A, 2010B and future bonds are secured primarily by loan repayments, BAB subsidy amounts and available amounts in the pledged equity fund, which holds excess loan repayments, deallocated reserves and invested moneys.
--The outstanding bonds (series 2001 - 2009) are secured by loan repayments, reserves and amounts available in the equity fund.

CREDIT SUMMARY:
The Iowa Finance Authority leverages moneys from its federally capitalized clean water state revolving fund (CWSRF) and drinking water state revolving fund (DWSRF) under a master trust agreement (MTA). With this issue, the authority will amend and restate its MTA, under which all previous clean water and drinking water SRF bonds have been issued ($480.4 million outstanding). The amended MTA transitions the program to a cash flow structure from the existing hybrid structure, where both program reserves and excess loan repayments secure the existing bonds. In addition, the amended MTA will pledge the equity fund so that new and recycled loan repayments, funded from bond proceeds or federal capitalization grants, will be used to cover deficiencies from

any program bonds, if needed, significantly enhancing bondholder security. The amended MTA will also allow for all future loan repayments to be pooled for use to pay any undesignated future series of bonds.

Loan repayments from 139 pool participants, with an aggregate outstanding balance of $413 million will secure the series 2010A and 2010B bonds totaling $274 million. In addition, the authority will use approximately $126 million of the series 2010 bond proceeds as reimbursement for loans recently issued with cash; those moneys will be deposited into the equity fund and will also secure the series 2010A, 2010B and any future parity bonds.

Under the amended MTA, excess loan repayments, reserve releases and interest earnings related to each series of outstanding MTA bonds, will continue to flow into the deficiency fund, which is available to make debt service payments on any outstanding clean water or drinking water bonds. Excess moneys in the deficiency fund, will flow to the equity fund, now pledged to all bond holders. The series 2010 and future bond issues are not secured by existing loan repayments. However, when any series of outstanding bonds fully mature, the existing loan repayments related to that series of outstanding bonds will be released from its lien, deposited into the equity fund and then pledged to all existing and future bond issues.

The pledged equity fund will be used to make new pledged loans, to receive reimbursement deposits (from bond proceeds or capitalization grants), to make up deficiencies in the program's bond fund, deficiency fund or rebate fund, and to receive capitalization grant deposits. The fund also provides cross-collateralization between the clean water and drinking water accounts. Any loan repayments from new loans that are on deposit in the equity fund will be pledged to bondholders at any time. Amounts in the Equity fund may only be withdrawn after meeting a 1.20 times (x) coverage test.

Upon issuance of the series 2010A and 2010B bonds and including the outstanding bond issues, combined annual debt service coverage from loan repayments is strong, ranging from 1.23x in fiscal 2010 to 2.29x in the later years reflecting a build up in equity. In addition, the authority maintains reserves pledged to certain outstanding bonds totaling $89 million, or 18.4% of total bonds outstanding. The reserves are primarily invested in fully collateralized investment agreements, money market funds, and U.S. agency securities. Overcollateralization from loan repayments, pledged reserves, reserve releases and interest earnings (excluding any BAB subsidy) allows the bonds to perform even if loan repayments experience a shortfall of 45.5% during the first four years of the bonds' life. This exceeds what Fitch would expect to occur for the program's loan portfolio in an 'AAA' stress scenario, given the pool's quality and diversity. The program can withstand 89.8% and 100% loan defaults during the middle and last four years, respectively, of the bonds life.

The loan pool has over 400 borrowers, although the largest borrower, Sioux City, accounts for 10%, and the top 10 borrowers account for about 41% of the total pledged portfolio. Fitch estimates at least 26% of the pledged loan portfolio has investment-grade credit characteristics. To date, the authority has never incurred a permanent loss on any of its pledged loans.

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Applicable Criteria and Related Research:

--'Revenue-Supported Rating Criteria' (Oct. 8, 2010);
--'State Revolving Fund and Municipal Loan Pool Rating Guidelines' (April 28, 2008).

For information on Build America Bonds, visit 'www.fitchratings.com/BABs'.

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=564565
State Revolving Fund and Municipal Loan Pool Rating Guidelines
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=384150